United States Court of Appeals

for the Second Circuit

APPELLANT'S PETITION FOR REHEARING EN BANC

77-1150

UNITED STATES COURT OF APPEALS

For the Second Circuit

United States of America,

Appellee,

-against-

AMREP Corporation, RIO RANCHO ESTATES, Incorporated, ATC REALTY Corporation, Howard W. Friedman, Chester Carity, Henry L. Hoffman, Daniel Friedman,

Defendants-Appellants.

Appeal from Judgment of the United States District Court for the Southern District of New York

---

PETITION FOR REHEARING AND SUGGESTION OF REHEARING IN BANC

PAUL, WEISS, RIFKIND, WHARTON & GARRISON
Attorneys for Defendants-Appellants
AMREP CORP., RIO RANCHO ESTATES, Inc.
and ATC REALTY CORP.
345 Park Avenue
New York, New York 10022
(212) 644-8000

Arthur L. Liman
Robert S. Smith
Robert Abrahams,
Of Counsel

CURTIS, MALLET-PREVOST, COLT & MOSLE
Attorneys for Defendants Chester Carity,
Daniel Friedman, Howard W. Friedman
and Henry L. Hoffman
100 Wall Street
New York, New York 10005
(212) 248-8111

Peter Fleming, Jr.
John E. Spriggs
Eliot Lauer,
Of Counsel

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 77-1150

UNITED STATES OF AMERICA,

Appellee,

v.

AMREP CORPORATION, RIO RANCHO ESTATES, INC., ATC REALTY CORPORATION, HOWARD W. FRIEDMAN, CHESTER CARITY, HENRY L. HOFFMAN, and DANIEL FRIEDMAN,

Defendants-Appellants.

PETITION FOR REHEARING AND SUGGESTION OF REHEARING IN BANC

Preliminary Statement

Pursuant to Rules 35 and 40, Fed. R. App. P., defendants-appellants ("defendants") respectfully petition this Court for rehearing of this appeal and suggest the rehearing of the appeal by this Court in banc.

The ground for this petition is that the panel opinion overlooked and misapprehended numerous points of fact and law, which are itemized below. Of particular

importance, the panel held that the individual defendants could be convicted and imprisoned on the basis of conduct by salesmen which defendants neither authorized nor knew about. The panel opinion expressly adopts a standard of whether the defendants "could have known by the exercise of reasonable diligence" that salesmen's statements to customers were false. (Op. p. 7) Thus the panel opinion would permit sending any high level corporate officer to jail on the basis of his negligence in failing to discover misconduct of lower level employees.

Misapprehensions of Fact

The panel opinion is replete with serious errors of fact. We can only infer that the panel accepted many of the egregious distortions of the record contained in the prosecution's brief. While we must refer to defendant's briefs on appeal for the full statement of the facts, we will call attention here to the following factual errors in the panel opinion:

1. The panel found that the individual defendants "participated in setting up a fraudulent sales program, trained and instructed the salesmen, prepared sales pitches widely and consistently used and monitored the results thereof." (Op. p. 6) There was no such evidence. The prosecution's own witnesses, Mandel and Zaknich, testified that <u>they</u> were responsible for these activities. The evidence showed only that the defendants were aware of the volume of sales, and attended one or more dinner parties.

2. There was no evidence that AMREP or any of the individual defendants were aware of any so-called "customers' complaints". (Op. p. 7)

3. The panel found that "the government's proof was sufficient to establish that Albuquerque was not required to expand to Rio Rancho." (Op. pp. 2-3) But the prosecution itself has admitted that Albuquerque is required to expand to Rio Rancho (Govt. Br. pp. 42, 54), and every witness, including the prosecution witnesses, agreed. The prosecution's claim was that Albuquerque was not required to expand "only" to Rio Rancho. The panel failed to address the question of whether a mail fraud conviction may be sustained by reason of a defendant's use of the word "only", where the undisputed evidence established that Albuquerque must expand to Rio Rancho as it grows, and where there was no evidence that the defendants meant anything more than this.

4. The finding of falsity with regard to the representation that an investment in Rio Rancho land was a good financial investment is without foundation. The only evidence to which the panel opinion points in support of this finding is to the effect that "there was an extremely limited resale market for Rio Rancho lots". (Op. p. 3) The panel overlooked the utter absence of any proof that this relatively short-term illiquidity rendered an investment in subdivided real estate a bad investment; it ignored the evidence that state regulatory agencies allowed the property to be sold as a good investment

while at the same time requiring written disclaimers as to short-term illiquidity, the substantial and undisputed evidence of appreciated value, and the prosecution's failure to produce any witnesses, expert or otherwise, to give testimony that short-term illiquidity made Rio Rancho land a bad investment.

Errors of Law

I

THE PANEL ERRED IN ITS TREATMENT OF THE ADMISSIBILITY OF IDIOSYNCRATIC SALESMEN CONDUCT AND STATEMENTS WHICH WERE UNKNOWN TO, AND INDEED PROHIBITED BY, THE DEFENDANTS

This appeal raises the far-reaching issue of whether corporations and senior corporate officials may be held criminally responsible for the unauthorized and prohibited conduct of corporate employees, where no evidence is presented to establish that the corporation or its senior officers knew or were aware of the employee conduct in question.

The opinion of the panel filed on August 8, 1977, answered this question in the affirmative. It held that unauthorized, prohibited and undiscovered employee conduct was binding on the defendant corporations and various senior officers, so long as that conduct, even if prohibited, had to do with the basic business of the corporation.

If the opinion is sustained, a new rule of criminal law will be promulgated. For example, senior officers of General Motors, and General Motors itself, could be held

criminally responsible for unauthorized and even prohibited dealer misrepresentations as to promotional matters such as the gas mileage, safety, and durability of General Motors automobiles.

Especially in this time of ever-expanding prosecutional reach, we submit that the opinion poses a genuine danger to the fair administration of criminal justice by expanding previously established boundaries of imputed corporate and individual criminal liability beyond rational limits.

The panel opinion does not contest the prejudicial impact on defendants of massive evidence of unauthorized, diverse, and idiosyncratic conduct and statements of various salesmen. Rather, the panel found two grounds for holding that the evidence was admissible. The panel held that (1) the evidence related to acts in furtherance of the alleged scheme and (2) the defendants were negligent in failing to learn that salesmen were making false representations. Both bases for the panel's holding are unsound, for the reasons which follow.*

---

* The panel's reference to the common representation of corporate and individual defendants (Op. pp. 4-5) is irrelevant to the admissibility of this evidence. The fact that the same lawyers may represent corporate and individual parties does not establish that evidence of idiosyncratic misconduct by low-level employees is admissible against any or all of these parties. Moreover, the panel's summary of the facts is wrong. The corporate defendants were separately represented from the outset of the criminal case. An attorney from the firm representing defendants Howard Friedman and Hoffman was substituted for one corporate defendant shortly before trial.

(continued)

A. "Furtherance" Basis

The panel opinion states (Op. p. 5):

> So long as a transaction is within the general scope of a scheme on which all defendants had embarked, a defendant not directly connected with a particular fraudulent act is nonetheless responsible therefor if it was of the kind as to which all parties had agreed. (Emphasis added)

While of legal merit in the ordinary conspiracy case, where the alleged agreement is general in nature and does not restrict the means to be employed to accomplish its purpose, this evidentiary principle is of no merit or applicability here.

In this case, as the prosecution conceded, the only evidence of agreement was to a "set sales program" from which there could be no deviation (Govt. Br. p. 8). This "set sales program" was limited to the dinner party scripts, property reports, and other company-authorized literature. Any sales tactics which went beyond this "set sales program" were both unauthorized and prohibited, and were never claimed to be otherwise.

The idiosyncratic salesmen conduct therefore was not "of the kind to which all parties had agreed" (Op. p. 5, supra), and the factual predicate for admissibility in a conspiracy case was entirely lacking.

(Continued)

Also irrelevant is the panel's reference to a comment in counsel's opening statement. (Op. p. 5) Counsel's reference to "representations which [his clients] permitted to be made" referred only to the authorized statements made in the "set sales program", not to the idiosyncratic conduct of salesmen.

[illegible] to [illegible] with the central issue of whether the defendants [illegible] and believed that the representations were false. The [illegible] issue of [illegible] was ignored.

The opinion does state on this issue that "[self-]belief, even if honest, does not justify baseless representations." (Op. p. 7) The only fair reading of this statement is that the original panel decided that the defendants, even if they believed in the representations in question, were guilty of fraud since the representations were without basis.

We agree that representations, false in fact, are also fraudulent when there is no factual basis for them, as we have previously argued (Petition Br., pp. 35-37), where the evidence "establishes the absence of any rational basis" for the representations. But here, defendants had substantial reason to believe that the representations in question were true. There was no evidence from which the jury could find them to be "baseless."

V. Intent to Defraud

The prosecution certainly did not establish the absence of a rational basis for disagreement as to the [illegible] of Albuquerque's growth.

The Rio Rico Association, an organization of Albuquerque civic leaders, promoted economic growth in the northern triangle, with a population influx of 250,000 by 1985. This promotion was contained in "Rio Rico Story", a fact which the prosecution introduced in its own case. And, as the defense

case, it was shown that a former city planner, Yguado, had written as early as 1963 that Albuquerque physically could only grow to the west and northwest, and that this growth would take place in the northwest mesa where Rio Rancho was located. These opinions, which were essentially identical to the defendants', were grounded on a "sound factual and historical basis." B & B, Inc. v. Newberg, 488 F.2d 742, 745-746 (9th Cir. 1973); see also Mere v. Computer Science Corporation, 507 F.2d 885, 889-890 (9th Cir. 1974).

Indeed, the prosecution's own evidence established that the two contrary opinions upon which it based its case of falsity were wrong. Carruthers, one of its two witnesses, admitted that he had been wrong. The vacant land in northeast Albuquerque, which Carruthers, in 1965, had predicted could absorb more than 800,000 new residents, had absorbed less than 70,000 by 1975, and, as Carruthers also admitted, had gone "about as far as it could go" (A. 4710-15, 4724, 4670).

The other prosecution witness, Avellanet, had also predicted that 800,000 additional people could be accommodated in northeast Albuquerque alone. He relied upon an automobile view and an offhand prediction of increased density. It is not surprising that his prediction of northeast capacity was proved to have been off by more than 330,000 people.

The prosecution's burden was to prove bad faith by direct evidence or by evidence that the defendants' opinion had no rational basis in fact. No such evidence was forthcoming.

Bad faith was not proved. For this reason, even if the jury could properly find that the defendants' prediction was wrong, there was no basis for a finding of fraud.

The panel opinion does not even deal with this issue.

B. Good investment

As with the direction of growth issue, the fact that reasonable men might reach a conclusion contrary to the defendants' would not, in and of itself, establish bad faith. Under the applicable standard, bad faith would be established only if there could be no rational disagreement with the prosecution's idea that relatively short-term illiquidity in subdivided real estate establishes that it is a bad investment.

The prosecution did not even try to prove any such universality of opinion. No expert was called to give such an opinion. And the prosecution, which did call certain Albuquerque realtors, failed to seek their view as to the investment value of Rio Rancho land.

The representation of "good investment" was not baseless. Substantial evidence of appreciated value and profitable resales was introduced and not contested. It was proved on the prosecution's own case, without dispute, that state regulators did not agree with the theory that illiquidity meant that Rio Rancho land was a bad investment. Both New York and New Jersey allowed the defendants to sell their land as a good investment while at the same time insisting upon a written disclaimer of liquidity. Obviously those states did not share the prosecution's

belief that illiquidity was conclusive proof of a bad real estate investment.

In the end, it was the prosecution's burden to prove a universality of opinion in this regard. The prosecution did not, and did not even try to. Again, there was no basis for a jury finding of bad faith -- and the panel opinion does not even deal with this issue.

III

OTHER ERRORS REQUIRE REVIEW ON REHEARING OR REHEARING IN BANC

The following points of law were also overlooked or misapprehended in the panel opinion:

1. For the reasons stated at pages 3-4 above there was insufficient evidence for the jury even as to the falsity of the two representations at issue in the case. The prosecution never produced any evidence from which the jury could find that Albuquerque was not required to expand to the northwest or that Rio Rancho land was not a good investment.

2. The case of United States v. Natelli, 527 F.2d 311 (2d Cir. 1975), cert. denied, 425 U.S. 934 (1976), while arguably not relevant in the ordinary mail fraud prosecution, is relevant to this case, contrary to the panel's determination. (Op. pp. 8-9) As the panel correctly states, the crime charged in Natelli consisted of the making of false statements in a proxy statement, and the erroneous failure of the trial court to direct a verdict as to one of the statements rendered the jury's verdict ambiguous and required a new trial.

While this case involves alleged mail fraud, in the end it, like Natelli, boiled down to two alleged false statements. The trial court specifically instructed the jury that it could convict on the basis of either statement. (A 7970) Since there was no evidence whatsoever connecting Daniel Friedman to any evidence of falsity with regard to the representation of northwest growth, at least his conviction must be reversed under Natelli. Further, if the evidence relating to the other defendants is insufficient as to either alleged statement, all of the convictions must be reversed.

3. The panel's reliance upon United States v. AMREP Corp., 545 F.2d 797, 800 (2d Cir. 1976) in order to justify the reading of the defendant Friend's grand jury testimony is misplaced. That prior decision in this case arose out of a petition filed by the prosecution to review certain pretrial evidentiary rulings. The portion of Friend's grand jury testimony of which we complain was not presented to this Court for a determination of admissibility at that time.

Moreover, the panel opinion ignores our basic point. Even if Friend's grand jury testimony were admissible in a joint trial, the trial court abused its discretion by allowing the prosecution to read that testimony to the jury when, almost immediately thereafter, the same trial court dismissed the case against Friend and struck the grand jury testimony.

4. The panel opinion wholly fails to discuss the failure of proof on the Interstate Land Sales Counts. (See AMREP Br. pp. 83-85)

Conclusion

For the foregoing reasons, we respectfully submit that this Court should grant rehearing or rehearing in banc of this appeal, and that pending such rehearing the mandate should be stayed.

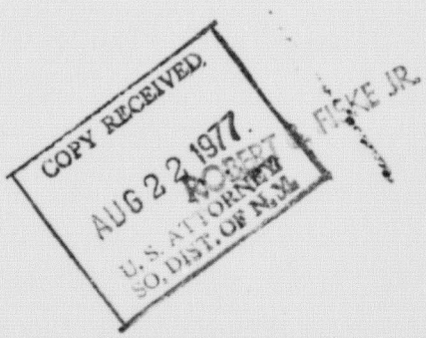
Dated: New York, New York
August 22, 1977

Respectfully submitted,

PAUL, WEISS, RIFKIND, WHARTON & GARRISON
Attorneys for Defendants AMREP Corporation, Rio Rancho Estates, Inc. and ATC Realty Corporation

and

CURTIS, MALLET-PREVOST, COLT & MOSLE
Attorneys for Defendants Howard W. Friedman, Chester Carity, Henry L. Hoffman and Daniel Friedman


COPY RECEIVED.
AUG 22 1977
U.S. ATTORNEY
SO. DIST. OF N.M.